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No. 82-1806

In the Supreme Court of the United States

OCTOBER TERM, 1982

HAWAIIAN INDEPENDENT REFINERY, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT (FORMERLY THE UNITED STATES COURT OF CLAIMS)

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioner seeks review of the decision below in this federal income tax case holding that it was not entitled to an investment tax credit for the entire cost of an oil refinery complex because part of the facility had been "constructed" by petitioner prior to the effective date of the statute reinstituting the credit and had not been "acquired" by petitioner after that date.

The pertinent facts may be summarized as follows. Petitioner Hawaiian Independent Refinery, Inc. was incorporated in 1968 to develop and operate a petroleum refinery (Pet. App. A-5). The complex was to consist of three major components: a refinery, an off-shore tanker-mooring facility with underwater/underground pipelines connecting it to the refinery; and two pipelines to transport the refined

petroleum products to storage facilities (*ibid*). Petitioner hired three firms to design and supervise the construction of these components and three prime contractors for their construction. It also arranged for a foundation study, soil tests, and clearing and grading the refinery site (*id.* at A-5 to A-6). Petitioner's contracts with Foster Wheeler, the design engineer, construction supervisor and prime contractor for the refinery, specified that petitioner should at all times bear the risk of damage to, or loss of materials, equipment, tools and supplies, that petitioner would have the right to require changes in the work provided it was willing to pay for them, and that petitioner could specify, and had the right to reject, suppliers and subcontractors (*id.* at A-8 and A-9).

Although petitioner had few employees during the construction period, their role in determining the size and design of the complex was significant. For example, one of petitioner's professional employees worked with Foster Wheeler to change Foster Wheeler's design in order to save 5 to 10% of the cost of the refinery (Pet. App. A-49 to A-50). Similarly, the design of the pipeline system, as well as the mooring system of the marine terminal, was changed at petitioner's request (*id.* at A-55). Petitioner's employees visited the worksite several times a week to check workmanship and to ensure that all installations complied with the plans (*id.* at A-54). Petitioner purchased substantial portions of the equipment and supplies needed for construction of the refinery (*id.* at A-48) and most of the materials needed for the construction of the marine terminal and the products pipeline (*id.* at A-57). In addition, petitioner obtained all necessary permits, easements, rights of way, safety clearances and insurance for the project (*id.* at A-51 to A-54, A-56 to A57). Construction of the refinery began in January 1971. It was placed in service in June 1972, but not completed until 1973. Construction of the marine terminal and

product pipeline began some time after April 1, 1971. The entire complex cost $31,800,587. (*id.* at A-54).

Petitioner claimed investment tax credits totaling $2,226,041 on its federal income tax returns for 1972, 1973 and 1974. On audit, the Internal Revenue Service disallowed $963,749 of the claimed credit on the ground that petitioner had constructed a portion of the facility during a part of 1971 when the investment tax credit was not in effect. See Sections 49 and 50 of the Internal Revenue Code of 1954 (26 U.S.C.) Petitioner paid the resulting assessment of additional taxes, filed a claim of refund and, upon its denial, filed this suit for refund in the United States Court of Claims (Pet. App. A-57). After hearing extensive testimony and considering a substantial number of exhibits (*id.* at A-13), the court determined that in view of petitioner's substantial control over the design and construction of the refinery complex, the facility must be considered as having been constructed by the petitioner, not merely acquired by it after the construction was complete. Accordingly, the court concluded petitioner was not entitled to the investment tax credit based upon the costs it incurred prior to the 1971 effective date of the statute (*id.* at A-39).

1. The decision below correctly held that petitioner's control over the design and construction of the oil refinery complex required that it be regarded as having constructed the complex within the meaning of the investment tax provisions.

Section 38 of the Internal Revenue Code of 1954 (26 U.S.C) authorizes the allowance of a tax credit with respect to investments in "Section 38 property." In late 1969, Congress terminated the investment credit by adding Section 49 to the 1954 Code, which provides that the term "section 38 property" would not include property the construction of which was begun after April 18, 1969, or property acquired

after that date. Tax Reform Act of 1969, Pub. L. No. 91-172, § 703(a), 83 Stat. 660. Approximately two years later, however, Congress restored the investment tax credit by enacting Section 50 of the 1954 Code. Revenue Act of 1971, Pub. L. No. 92-178, § 101(a), 85 Stat. 498. Section 50(a) provides, in pertinent part, that "(1) [property] * * * the construction * * * of which—(A) is completed by the taxpayer after August 15, 1971, or (B) is begun by the taxpayer after March 31, 1971, or (2) [property] * * * acquired by the taxpayer—(A) after August 15, 1971, or (B) after March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971" is eligible for the tax credit. This general rule is qualified, however, by subsection (b) of the statute which contains a "Transitional rule" pertaining to "property described in subsection (a)(1)(A) the construction * * * of which is begun before April 1, 1971." It provides that, with respect to such property, "there shall be taken into account only that portion of the basis which is properly attributable to construction * * * after August 15, 1971."[1] 26 U.S.C. 50(b).

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[1]Treasury Regulations, Section 1.50-1(c) (26 C.F.R.) provides that "[t]he principles of [Regulation] § 1.48-2(b) and (c) shall be applied in determining when property is acquired and in determining that portion of the basis of property properly attributable to construction * * * after August 15, 1971." Section 1.48-2(b) provides in pertinent part that—

> (1) Property is considered as constructed * * * by the taxpayer if the work is done for him in accordance with his specification.
>
> * * * * *
>
> (5) Construction * * * by the taxpayer begins when physical work is started on such construction * * *.
>
> (6) Property shall be deemed to be acquired when reduced to physical possession, or control.

The decision below correctly held that the oil refinery complex was not property "acquired" by it after the effective date of the investment credit as reinstituted by Section 50 of the 1954 Code. Rather, the complex was property a portion of which was "constructed" by petitioner prior to such effective date, thereby bringing into play the transitional rule of Section 50(b). The courts have regarded the right of control as the most important factor in determining whether work is done for the taxpayer "in accordance with his specifications" so as to be deemed to be "construct[ed]" by the taxpayer, as opposed to property constructed by a third party and then "acquired" by the taxpayer (26 C.F.R. 1.48-2(b)(1), (5) and (6)). See *Lykes Bros. Steamship Co.* v. *United States,* 513 F.2d 1342, 1348 (Ct. Cl. 1975); *Public Service Co.* v. *United States,* 431 F.2d 980, 983 (10th Cir. 1970).

Here, the facts, extensively detailed by the court below, demonstrate that petitioner controlled both the design of the facility and the details of its construction. Specifically, petitioner selected the prime contractors and had veto power over the selection of subcontractors and vendors. It purchased much of the construction equipment, materials, and supplies itself and it alone assumed the risk of loss. Moreover, petitioner retained and actually exercised control over the contract plans and specifications at every stage of the design and construction of the complex. It possessed the right to modify the specifications and in several instances both before and during construction it made material changes in those specifications. Finally, petitioner's employees inspected the project several times each week during its construction. Upon completion, they conducted a final inspection during which they discovered numerous defects which had to be corrected before petitioner would accept the work (Pet. App. A-20). On these

facts, the decision below was amply justified in concluding that petitioner had constructed the oil refinery complex.[2]

2. Contrary to petitioner's assertion (Pet. 7), the decision below does not conflict with *Lykes Bros. Steamship Co., Inc.* v. *United States, supra.*[3] Indeed, the court below expressly applied the control test fashioned by the Court of Claims in *Lykes Bros.* The different results reached merely reflect the substantial difference in the facts of the two cases. Similarly, there is no direct conflict between the decision below and the decision in *Public Service Co.* v. *United States, supra.* As the decision below demonstrates (Pet. App. A-7 to A-9), the control exercised by petitioner over the design and construction of the project was far greater than that exercised by the taxpayer in *Public Service Co.*

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

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[2]The decision below, moreover, properly implements Congress' intent underlying the statutory provisions. In 1969, Congress discontinued the investment tax credit to deter capital spending that was then contributing to demand-fueled inflation. It chose termination of the credit rather than suspension to prevent businesses from obtaining the credit merely by deferring their investments to a later period. See H.R. Rep. No. 91-413 (Pt. 1), 91st Cong., 1st Sess. 178 (1969); S. Rep. No. 91-552, 91st Cong., 1st Sess. 224 (1969). Construction of petitioner's complex, which began in January 1971, was in no way induced by the credit. Hence, allowance of the credit with respect to costs incurred before the effective date of Section 50(a) would result in a windfall.

[3]At all events, since the United States Court of Appeals for the Federal Circuit has supplanted the Court of Claims, any conflict between decisions of the latter court and its successor provides no basis for invoking this Court's jurisdiction. See R. Stern & E. Gressman, *Supreme Court Practice* 275-276 (5th ed. 1978); cf. *Davis* v. *United States*, 417 U.S. 333, 340 (1974).